

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

IN RE:)	CHAPTER 13
)	
TELESFORO RODRIGUEZ,)	CASE NO. 00-31889
)	
DEBTOR.)	Re: DOC. I.D. NO. 12, 21, 49

MEMORANDUM AND ORDER ON REMAND

I. Procedural and Factual Background

An understanding of the lengthy and somewhat tortured factual and procedural background of this case is necessary in order to appreciate the Court's determination of the instant matter on remand from the United States District Court for the District of Connecticut.

On January 22, 1999, Telesforo Rodriquez, Jr. (hereafter, the "Debtor") filed a petition for relief under Chapter 13 of the United States Bankruptcy Code. The Petition was accompanied by a Chapter 13 Plan, and the Statement and Schedules required by Fed. R. Bankr. P. 1007.

The Debtor's principal residence, known as and numbered 35-37 Maltby Place, New Haven, Connecticut (hereafter, the "Residence"), is a two-family dwelling containing a non-owner-occupied unit rented to tenants. The Residence is encumbered by, *inter alia*, a first mortgage deed (hereafter, the "Mortgage") and separate assignment of rents (hereafter, the "Rent Assignment") in favor of Chase Manhattan Mortgage Corporation (hereafter, "Chase").

In the early stages of his Chapter 13 case, the Debtor prosecuted a Motion to Determine Status of Claims (hereafter the "Status of Claims Motion"), Doc. I.D. No. 12, and

Chase responded with an Objection to Motion to Determine Status and Memorandum of Law in Support, Doc. I.D. No. 21. After due notice, the Status of Claims Motion came before the Court for a hearing on October 12, 2000 (hereafter, the “Initial Hearing”). At the Initial Hearing, Chase contended that its claim of \$138,504.27 was fully secured pursuant to Bankruptcy Code Section 506(a). In supporting that conclusion Chase claimed that its security interest should be valued by aggregating the value of the Mortgage and the Rent Assignment (hereafter, the “Stacking Theory”). In furtherance of that approach, Chase produced expert testimony that (i) the fair market value of the Residence was \$87,000.00,¹ and (ii) the present value of a rental stream from the Residence was approximately \$131,000.00. By contrast, the Debtor rejected the Stacking Theory, and produced expert testimony which asserted the fair market value of the Residence to be \$46,000.00.²

The Court, after receiving and reviewing the evidence, and considering arguments of the parties thereon, issued a Brief Memorandum and Order on Status of Claims, Doc. I.D. No. 22 (hereafter, the “Status of Claims Order”), finding the value of the Residence, and Chase’s secured claim, to be \$87,000.00. The Debtor’s Amended Chapter 13 Plan was confirmed by this Court on January 19, 2001, Doc. I.D. No. 26 (hereafter, the “Confirmation Order”); and Plan payments were initiated through payroll deduction.³

¹ This valuation was a reconciliation of independent “comparable sales”, “replacement cost” and “income-approach” analyses.

² This appraisal was based solely upon a comparable sales approach to valuation of the real property.

³ According to the Chapter 13 Trustee, as of July 29, 2004, the Debtor had faithfully completed approximately four years of his five-year Chapter 13 Plan. At that time the Debtor had paid in nearly \$90,000.00, of which \$48,000.00 had been distributed to Chase.

The Status of Claims Order explicitly rejected the Stacking Theory through, *inter alia*, express adoption of the reasoning of United States Bankruptcy Judge Robert L. Krechevsky in his unpublished Ruling on Debtor's Motions for Determination of Secured Status... (Bankr. D. Conn. November 21, 2000) in the case of In re Thompson (Case No. 00-21213) (hereafter, the "Thompson Bankruptcy Court Ruling").⁴ On the date this Court's Status of Claims Order was docketed, the Thompson Bankruptcy Court Ruling was on appeal by Chase to the United States District Court for the District of Connecticut (Civ. No.: 01CV00617), and was subsequently affirmed by United States District Judge Alvin Thompson in an unpublished ruling (hereafter, the "Thompson District Court Ruling"). Chase then took an appeal of the Thompson District Court Ruling to the United States Court of Appeals for the Second Circuit (No. 02-5034) (hereafter, the "Thompson Circuit Appeal").

In similar fashion, Chase appealed this Court's Status of Claims Order and Confirmation Order to the United States District Court. By an unpublished ruling and order dated November 26, 2002 (Doc. I.D. No. 49) (hereafter, the "Ruling" or "Rodriguez District Court Ruling"), United States District Judge Stephan R. Underhill reversed the Status of Claims Order and Confirmation Order, and remanded the matter to this Court for further proceedings consistent with that Ruling. The Rodriguez District Court Ruling was then appealed by the Debtor and the Chapter 13 Trustee to the United States Court of Appeals for the Second Circuit, where those appeals (hereafter, the "Rodriguez Circuit Appeals")

⁴ In the *Thompson* Bankruptcy Court Ruling - also involving Chase as secured creditor - Judge Krechevsky held, *inter alia*, that "Chase's contention, that the value of its security interest is the sum of the fair market value of the underlying property (\$75,000) plus the present value of the rental income stream (\$183,908.46) is *meritless*." *Thompson* Bankruptcy Court Ruling at 4 (emphasis added).

appear to have been temporarily jointly administered with the Thompson Circuit Appeal.

On April 16, 2003, the parties to the Rodriguez Circuit Appeals filed with the Circuit Court a Stipulation Withdrawing Appeal from Active Consideration without Prejudice, with Leave to Reactivate, which provided, in pertinent part, that --

“... the [appeals] are hereby withdrawn from active consideration from the Court, such withdrawal to be without prejudice to a reactivation of the appeals by each appellant’s counsel so notifying the Clerk of this Court in writing by 30 days after 2d Cir. Decision in Thompson, 02-5034.”

(underscoring in original). As a result of this stipulated withdrawal of the Rodriguez Circuit Appeals, this Court set dates for remand proceedings as directed by the Rodriguez District Court Ruling. On each of those dates, however, the remand hearing was adjourned with the understanding that the matter would be actually heard, and finally determined, only following the Circuit Court’s resolution of the Thompson Circuit Appeal.⁵

On October 9, 2003, a panel of the United States Court of Appeals for the Second Circuit *affirmed* the Thompson District Court Ruling, finding “all of Chase’s arguments. . . to be without merit”. In re Thompson, 352 F.3d 519, 521 (2d. Cir. 2003) (hereafter, the “Thompson Circuit Opinion”).⁶ In view of the Thompson Circuit Opinion, this Court scheduled a further remand hearing in Rodriguez for March 4, 2004, with the expectation that the parties would address the matter in light of, and consistent with, the Thompson Circuit Opinion. Chase, however, did not appear on that date.

⁵ The *Thompson* Circuit Appeal and *Rodriguez* Circuit Appeals raised what this Court perceived to be identical issues with respect to “stacking” security interests in real property.

⁶ On February 25, 2004 the Circuit Court dismissed the *Rodriguez* Circuit Appeals in light of the pending remand from the District Court to this Court.

By letter dated March 19, 2004, Chase's counsel, Edward C. Taiman, Jr., advised this Court that there existed "a great difference of opinion" as to whether the Thompson Circuit Opinion was controlling of the disposition of the remanded Status of Claims Motion in Rodriguez. Accordingly, this Court ordered, *inter alia*, that the parties file and serve briefs addressing the following:

(i) the procedural history and present posture of the present matter, including, without limitation, whether the matter is properly pending before this Court, on remand or otherwise;

(ii) the extent, if any, to which the material facts in the present matter are distinguishable from the facts in Thompson;

(iii) the extent to which Thompson is controlling in this case, by purported agreement or otherwise;

(iv) assuming Thompson *is not* controlling in this case, the specific valuation to be applied to the subject property in accordance with the District Ruling and Order; and

(v) assuming, Thompson *is* controlling in this case, the specific valuation to be applied to the relevant property.

This Court also set June 10, 2004, as a continued date for a further hearing on the remanded Status of Claims Motion (hereafter, the "Remand Hearing"). The Remand Hearing was thereafter continued to June 24, and then again to July 29, 2004, at which time the Court heard the arguments of counsel and the Chapter 13 Trustee, as well as the supplemental testimony of Chase's appraiser, Frank Teodosio (hereafter, "Teodosio").⁷

However, prior to the closure of the evidentiary record at the Remand Hearing, counsel for the parties requested - and received - a further continuance, advising that they

⁷ Teodosio's supplemental testimony was limited to an explication of the income-approach component of his previous appraisal.

had “tentatively” reached a settlement in principle, which, if acceptable to their clients, would result in a consensual resolution of the remanded Status of Claims Motion. However, having not received a stipulation as of late September 2004, the Court scheduled the matter for a final hearing on October 1, 2004 (hereafter, the “Final Remand Hearing”).

At the Final Remand Hearing counsel for Chase advised the Court that having *recently* read and considered a transcript of the October 1, 2003 oral argument in the Thompson Circuit Appeal, Chase would no longer assert its Stacking Theory. However, Chase’s abandonment of its Stacking Theory did not end the instant matter before this Court because, *inter alia*, by separate motion it asserted that the Court must nevertheless reopen the evidentiary record to receive updated appraisal testimony, and then re-value the Residence based on current fair market value.⁸

Further, despite Chase’s abandonment of its Stacking Theory, this Court must still determine how best to discharge its remand obligation in a situation such as this, where a subsequent Court of Appeals’ opinion casts doubt upon the District Court’s reversing/remanding Ruling. On one hand this Court might be viewed as bound to follow the authority of the Circuit Court precedent, even if that means defying the dictates of the District Court’s remanding Ruling. Under that approach, this Court would take it upon itself to “correct” the District Court’s remanding Ruling. On the other hand, it could be said that this Court, as a unit of the District Court, should dutifully follow the dictates of the remanding District Court Ruling, regardless of subsequent developments at the Circuit Court level that appear to this Court, and to the parties, to be controlling of a legal issue in

⁸ Chase’s *Motion to Reopen Evidence*, Doc. I.D. No. 68, is resolved by this Court adverse to Chase this same date.

the pending matter. Under this latter paradigm, the “correction” of the District Court Ruling is left to the District Court itself, on appeal, if any, of this Court’s ruling on remand.

In the present case, however, this Court deems it prudent to employ a third approach, detailed in the Discussion below. In short, this Court will read the Rodriguez District Court Ruling in a manner which seeks to harmonize it with the subsequent Circuit authority.

II. Discussion.

In assessing the Rodriguez District Court Ruling, this Court observes that while that opinion *recites* Chase’s Stacking Theory, Ruling at p. 3, it never explicitly *endorses* it. Further, although at several points the Ruling states that a separate assignment of rents constitutes a “security interest with value separate and distinct from the security interest granted by the mortgage”, or words to that effect, e.g., Ruling at 7, 9,⁹ it seems consciously to resist instructing this Court to “stack”, or combine, *independent* valuations of the Mortgage and the Rent Assignment. Accordingly, instead of serving as a clear endorsement of Chase’s Stacking Theory, the gravamen of the Rodriguez District Court Ruling seems to be its more general observation that “[t]o meet Code requirements, the valuation of Chase’s security interest must *reflect the present value of the income stream* that Rodriguez will generate from use of the property.” Ruling at 11 (emphasis supplied). This directive is based on the “disposition or use” language of Bankruptcy Code Section 506(a), and keys off the fact that the Debtor proposes to retain the Residence and generate

⁹ In fact, the “grant” language of the *Mortgage* also includes an “assignment” of rents. The separate Rent Assignment can more accurately be said to *amplify* the creditor rights flowing from the mortgage-based assignment.

income therefrom.

So far as it goes then, the Ruling's directive that the valuation "reflect" the income stream does not offend the Thompson Circuit Opinion.¹⁰ And a relatively trouble-free interpretation of the Ruling would state simply that the "disposition or use" language of Section 506 compels a court to base any valuation of a retained, income-producing property on an appraisal utilizing an *income*, as opposed to a "replacement cost" or "comparable sales" approach. Under such a reading, the Ruling's remand can be responded to simply by making a finding of the fair market value *based upon an income approach* appraisal.

Despite Ruling language suggesting otherwise,¹¹ the record already contains an income approach appraisal, and that appraisal was a factor in this Court's original valuation. Chase's valuation expert, Teodosio, actually appraised the property using three different valuation approaches (*i.e.* cost, income, and comparable-sales), and then provided

¹⁰ Unfortunately though, it is not clear from the Ruling to what extent, if any, value *other than* that attributable to the income stream should be considered. It could be argued that the Ruling supports the notion that there are at least *two* essential components in the valuation of any income-producing property - a "rent" component and a "real property" component. The strongest indication in this regard is the discussion at p. 7, wherein the Ruling utilizes a "bundle of sticks" metaphor, *i.e.* that a fee simple interest in a parcel of real estate is composed of multiple, alienable rights, or "sticks". The Ruling goes on to state that "the assignment of rents provides Chase a mechanism to secure its loan by retrieving a single 'stick' without retrieving the entire bundle." One might argue, contrary to the spirit of Thompson, that such reasoning implies that each "stick" has a value *independent* of the others. Yet, the fact that real estate is composed of discrete components says nothing about the appropriate *valuation* of those components. What is important to understand, and what the Ruling does not explore, is the extent to which a valuation of a given component, or "stick", is *dependent* on the disposition of that component, and/or of one or more of the other components. For example, if Chase exercised its rights under the rent assignment and started to siphon away the monthly rentals, the value of the physical property would radically decline in the eyes of anyone other than Chase. Further, if Chase interdicted the rents without paying the expenses of maintaining the property, the tenants would eventually move out, and the rental stream would dry up and be rendered valueless.

¹¹ See Ruling p. 4 (text and note at fn. 1) (suggesting that this Court valued the Residence based on comparable sale approach).

a final appraisal figure (\$87,000.00) which was a *reconciliation* of those three component appraisals. In isolation, Teodosio's income approach appraisal produced a value of \$87,600.

This Court will respond to the remand of the Rodriguez District Court Ruling by ascribing controlling weight to the income approach appraisal of Teodosio. Although that appraisal did not *explicitly* utilize a "present value" analysis, as suggested by the Ruling, it is nonetheless the best evidence before the Court of an income-based valuation,¹² and the methodology utilized by Teodosio is sufficiently consistent with the spirit of the Rodriguez District Court Ruling to form the basis for this Court's response on remand. Accordingly,

IT IS HEREBY DETERMINED AND ORDERED that

(i) The petition date fair market value of the Debtor's real property and principal residence, known as and numbered 35-37 Maltby Place, New Haven, Connecticut, is **\$87,600.00;**

(ii) for purposes of Chapter 13 confirmation, and pursuant to Sections 506(a) and 1322(b)(2), the claim of Chase, as successor to American Residential Mortgage Corporation, is allowed as a secured claim in the amount of \$87,600.00, and as an unsecured claim for the balance of said claim; and

(iii) to the extent a lien secures a claim against the Debtor that is not an allowed secured claim as a consequence of paragraph (ii) of this order, such lien is void pursuant to Bankruptcy Code Section 506(d), *provided, however*, that in the event the Debtor's

¹² Teodosio applied a "gross rent multiplier" to the projected monthly rental income.

Chapter 13 case is dismissed or converted to a case under Chapter 7 of the Bankruptcy Code, the lien(s) voided by this order shall be reinstated as of the date of such conversion/dismissal without further order of court.

BY THE COURT

DATED: June 8, 2005

Albert S. Dabrowski
Chief United States Bankruptcy Judge